



OFFICE OF THE UNDER SECRETARY OF DEFENSE

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WASHINGTON, D.C. 20301-4000

MAY 27 2003

PERSONNEL AND
READINESS

The Honorable Duncan Hunter
Chairman, Committee on Armed Services
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:


House Report 107-436 for Fiscal Year 2003 requires the Secretary of Defense to report the details of his long-term plan for military pay raises and his estimate as to when the gap in pay raise rates between the military and the private sector will be eliminated. The Secretary is required to report his findings and recommendations for correcting any problem to the Senate Committee on Armed Services and the House Committee on Armed Services by March 31, 2003. This report is enclosed.

The Ninth Quadrennial Review of Military Compensation (9th QRMC) evaluated the relative effectiveness of military compensation and made a number of comparisons of military pay to civilian earnings. It compared levels of pay for full-time year-round civilian males with officer and enlisted regular military compensation (RMC). The 9th QRMC found that the 70th percentile of earnings of civilians with some college education is the appropriate comparison group for enlisted personnel and the 70th percentile of earnings of civilians with baccalaureate and advanced degrees in professional and managerial occupations is the appropriate benchmarks for officer comparisons.

The Department's goal is to eliminate the gaps between enlisted RMC and the 70th percentile of earnings for civilians with some college and officer RMC and the 70th percentile of earnings for civilians with baccalaureate and advanced degrees in professional and managerial occupations. Thereafter, military pay should be set at the Employment Cost Index in order to maintain pay parity between military and private sector salaries.

A similar letter has been sent to the Chairman, Senate Committee on Armed Services.

Sincerely,


Charles S. Abell
Principal Deputy

Enclosure:
Military Pay: Assessment and Plans

cc:
The Honorable Ike Skelton
Ranking Member





Report
On
Military Pay
(Assessment and Plans)

Report to the Committees on Armed Services
of the
United States Senate and House of Representatives

May 2003

Prepared By:
Office of the Under Secretary of Defense
Personnel and Readiness

Report to Congress

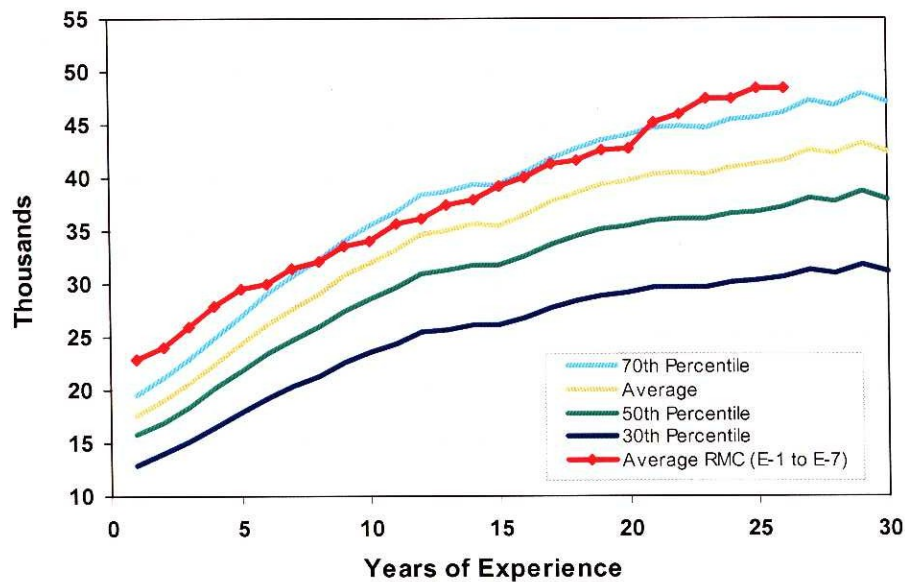
Military Pay: Assessment and Plans

In response to recruiting difficulties, a decline in retention, shortages in some skills and an increasing number of complaints about the adequacy of military pay, Congress passed major pay legislation for FY 2000. Military basic pay was increased 4.8 percent on January 1, 2000, and many members in selected pay grades and years of service received additional targeted increases on July 1, 2000. The overall increase in military pay was 6.2 percent, the largest increase since 1982 and significantly greater than the 4.3 percent increase in the Employment Cost Index (ECI). The July increases were generally targeted towards enlisted members and officers in the middle ranks and middle years of service although some pay cells in practically every grade received a targeted raise. In addition, the legislation called for across-the-board military pay raises through 2006 to be equal to the ECI plus one-half percent. The FY2000 pay raise was an attempt to fix a problem that was apparent in recruiting and retention and questions were raised almost immediately as to whether the pay raise was ‘enough.’

During this time frame, the Ninth Quadrennial Review of Military Compensation (9th QRMC) was chartered, with one of its principal objectives being to “assess the effectiveness of current military compensation and benefits in recruiting and retaining a high-quality force in light of changing demographics, a dynamic economy, and the new military strategy.” To assess the relative effectiveness of military compensation the 9th QRMC made a number of comparisons of military pay to civilian earnings. It found that since 1982 growth in basic pay had fallen behind the increase in civilian pay as measured by the ECI. This “gap” was between 5.5 to 13.5 percent in the year 2000.

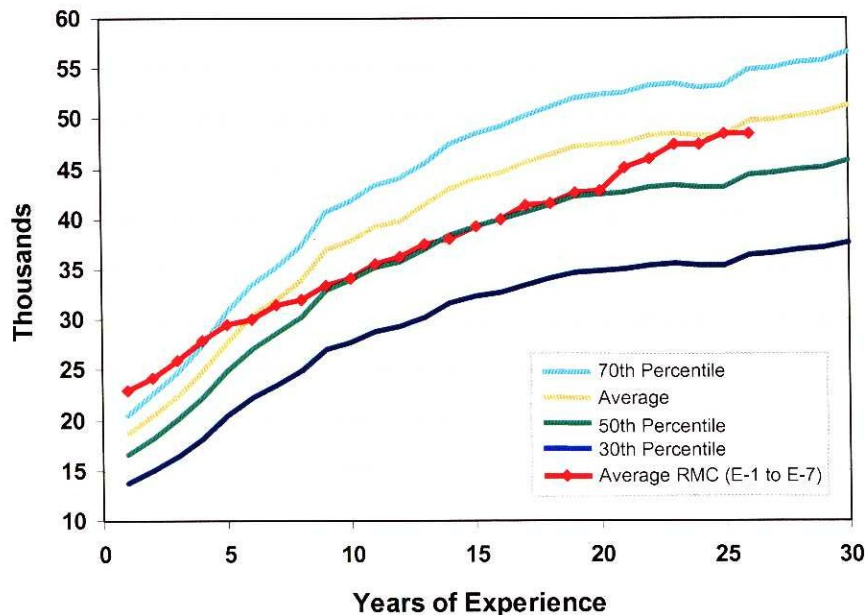
Regular Military Compensation (RMC) is the yardstick to be used in comparing the compensation of Uniformed Service members to the compensation of civilian-sector employees. RMC, as defined in title 37, United States Code, includes basic pay, basic allowance for housing, basic allowance for subsistence, plus an additional amount to account for the fact that the housing and subsistence allowances are not taxed. The 9th QRMC found that RMC “tracks reasonably well with the 70th percentile of earnings of high school graduates, and for the junior enlisted grades, RMC is actually above the 70th percentile” (See figure 1). However, the 9th QRMC argued that high school graduates are not the appropriate reference group for the enlisted force. Because of increased educational attainment on the part of the enlisted force, the 9th QRMC argued that earnings of civilians with some college education was the better benchmark to use than those of high-school graduates (Figure 2).

Figure 1. Comparison of Enlisted RMC to Civilian Earnings for High School Graduates (2000 dollars)



Note: Data reflect July 2000 enlisted pay (RMC) for E-1 to E-7 compared with predicted year 2000 earnings of male high school graduates.

Figure 2 Comparison of Enlisted RMC to the Earnings of Civilians with Some College Education (2000 dollars)

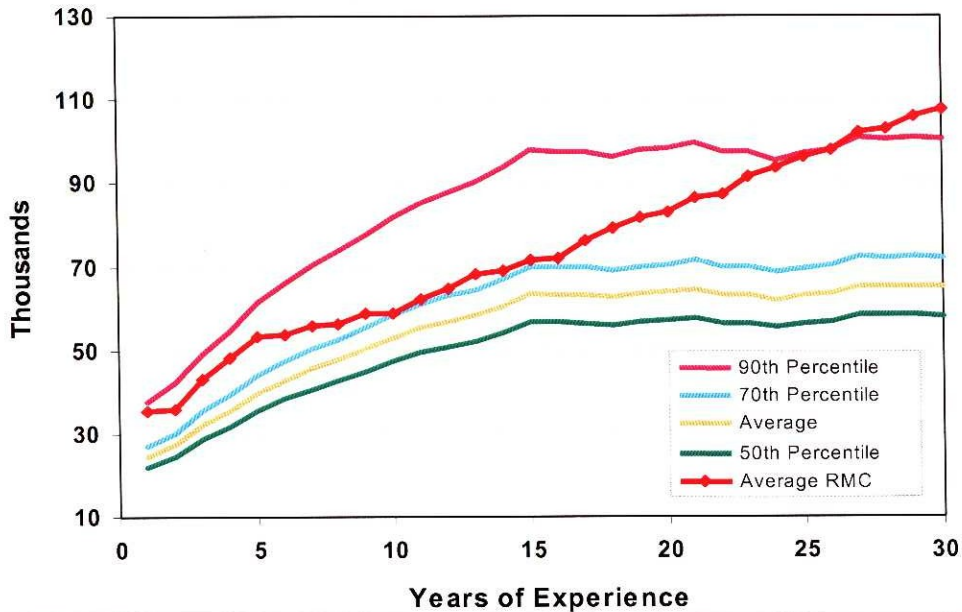


Note: Data reflect July 2000 enlisted pay (RMC) for E-1 to E-7 compared with predicted year 2000 earnings of males with some college.

Along similar lines, officers have, in the past, typically been compared to civilians with a baccalaureate degree (Figure 3). According to the 1999 Survey of Active Duty Personnel 40 percent of O-3s, 70 percent of O-4s and 90 percent of O-6s and above have advanced degrees.

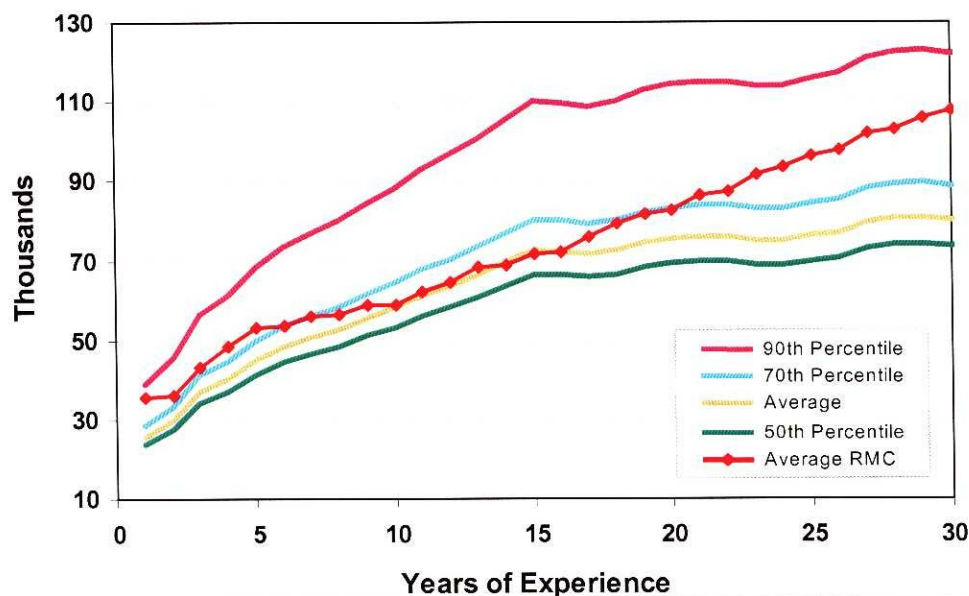
Recognizing the increased educational attainment of officers, the 9th QRM C argued that officer RMC should be compared to civilians with a baccalaureate degree or higher and limited to those employed in professional and managerial occupations. While officer RMC tracked at the 70th percentile when compared to civilians with a bachelor's degree, relative officer earnings were only at the average (50th percentile) when using this suggested benchmark (Figure 4).

Figure 3. Comparison of Officer RMC to Civilian Earnings of College Graduates (2000 dollars)



Note: Data reflect July 2000 officer pay (RMC) compared with predicted year 2000 earnings of male college graduates.

Figure 4 Comparison of Officer RMC to Civilian Earnings for Managers and Professionals with Baccalaureate or Advanced Degrees (2000 dollars)



Note: Data reflect July 2000 officer pay (RMC) compared with predicted year 2000 earnings of males in managerial and professional occupations with baccalaureate or advanced degrees.

While increased compensation may be needed whenever the Services are unable to meet their recruitment goals, retention rates fall, productivity falters or morale becomes a problem, in the past this has been associated with displacement from the 70th percentile. Consequently, the 9th QRMC and the Services concluded that the 70th percentile of earnings for civilians with some college and civilians with baccalaureate and advanced degrees in professional and managerial occupations should be the appropriate benchmarks respectively for enlisted and officer comparisons.

With the goal of eliminating the gaps between enlisted RMC and the 70th percentile of earnings for civilians with some college and officer RMC and the 70th percentile of earnings for civilians with baccalaureate and advanced degrees in professional and managerial occupations, the Department requested, and Congress agreed to additional targeted raises in 2001, 2002 and 2003. In 2001, basic pay was increased 3.7 percent in January, a raise that exceeded the ECI by 1/2 percent, with an additional .4 percent in July that was targeted to mid-career NCOs and officers. The 2002 pay raise was 6.9 percent, the largest increase in basic pay in 20 years. All members received a minimum increase of 5 percent with some members receiving targeted pay raises of up to 15 percent. Enlisted members serving in the E-5 to E-7 grades with 6-20 years of service received basic pay increases of 7.5 to 8.5%. This was a direct effort to alter the pay structure and thus the shape of the earnings profile, increasing the rate of increase in earnings for mid-grade enlisted members as suggested by the 9th QRMC. Not all of the targeted raises were directed to enlisted members in years of service groups with the largest gaps. Basic pay for grades E-8 and E-9 was increased from 9 to 10%, to recognize their extensive experience and levels of responsibility, to provide an incentive throughout one's enlisted career, and to prevent pay inversion. Basic pay for grades O-3 and O-4 was increased from 6 to 6.5%, to provide increased retention incentives. Additional adjustments were made for selected Warrant Officer pay cells for consistency and to prevent pay compression.

The 2003 pay raise averaged 4.7 percent. All members received a minimum raise of 4.1 percent equal to ECI+1/2 percent. An additional \$300 million was targeted to mid-grade officers and NCOs, with raises of up to 6.5 percent.

Figures 5 and 6 show the improvement in the relative position of military pay in comparison to civilian benchmarks as a result of the 2000 through 2003 pay raises. In 2004 dollars, the amount of money that was needed to increase enlisted military pay to the 70th percentile of civilians with some college was approximately \$3.5 billion. The 2001 pay raise lowered the needed increase in military pay to \$2.5 billion. By the start of 2003, the needed increase had decreased to \$1.3 billion, approximately one-third of the original deficit.

The picture for officers is very different. As can be seen in Figure 4, the disparity between the 70th percentile civilian benchmark and officer RMC was not as large as for the enlisted ranks. As shown in Figure 6, the 2001 pay raise closed a substantial portion of the needed increase in compensation and with the 2003 pay raise, the disparity has been eliminated for virtually all officers.

It is the Department's objective to eliminate the disparity between the earnings of military members as represented by RMC and the earnings of comparable civilians by 2006. Achievement of that objective would require additional targeting in 2004, 2005, and 2006. For 2004, the Department is proposing approximately \$180 million in targeted raises. This added money will reduce the shortfall to about \$1 billion. The Department anticipates additional

targeting in 2005 that would lower the shortfall by approximately one-half, with the remainder associated with the 2006 pay raise.

Figure 5 *Comparison of Enlisted RMC to the Earnings of Civilians with Some College Education.*

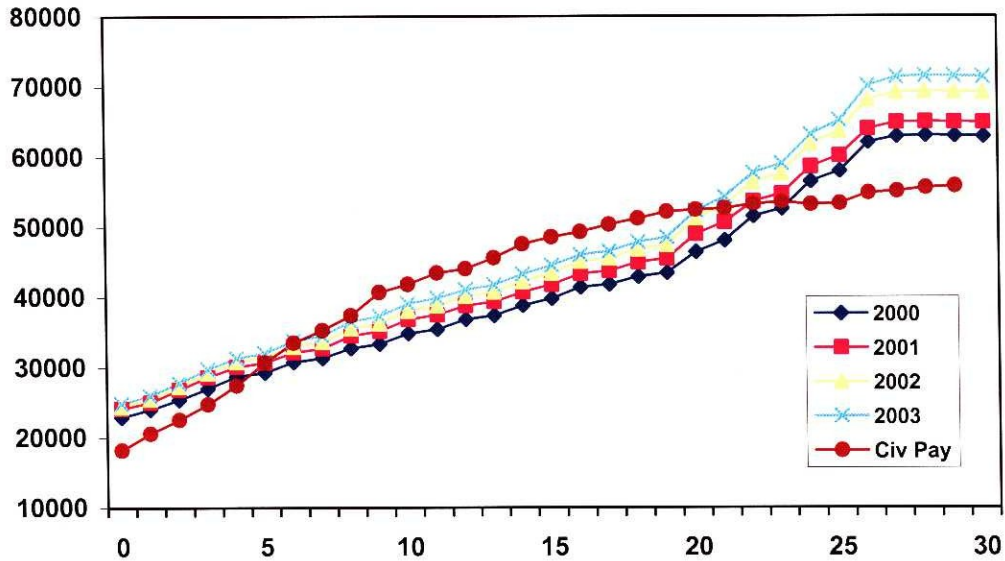


Figure 6 *Comparison of Officers RMC to the 70th Percentile of Civilians Earnings for Managers and Professionals with Baccalaureate or Advanced Degrees.*

